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Testimony to the Michigan Senate Committee on Finance

Ferdinand Hogroian
Legislative Counsel
Council On State Taxation (COST)

June 12, 2013

Re: COST's support for S.B. 367, Corporate Affiliated Group Election

Dear Chairman Brandenburg, Vice-Chairman Jansen and Members of the Committee:

On behalf of the Council On State Taxation ("COST"), I write in support of S.B. 367, a bill to provide corporate taxpayers with an "affiliated group election" for reporting income subject to the corporate income tax ("CIT"). This bill would increase certainty regarding the entities included in the combined corporate return, aiding compliance for taxpayers and administration for the Department of Treasury.

About COST

COST is a nonprofit trade association based in Washington, DC. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of nearly 600 major corporations engaged in interstate and international business. COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

COST Policy Statement on Combined Reporting

The COST Board of Directors has adopted a formal policy statement on combined reporting for state corporate income tax.¹ That statement notes the policy objections to combined reporting, in particular the uncertainty that results from its reliance on determining the unitary group:

The concept of a "unitary business" is uniquely factual and universally poorly defined. It is a constitutional (Due Process) concept that looks at the

¹ Available at

http://www.cost.org/uploadedFiles/About_COST/Policy_Statement/Mandatory%20Unitary%20Combined%20Reporting.pdf.

business as a whole rather than individual separate entities or separate geographic locations. In order to evaluate the taxpayer's determination of a unitary relationship, state auditors must look beyond accounting and tax return information. Auditors must annually determine how a taxpayer and its affiliates operate at a fairly detailed level to determine which affiliates are unitary... Determining the scope of the unitary group is a complicated, subjective, and costly process that is not required in separate filing states and often results in expensive, time-consuming litigation.

S.B. 367 Would Increase Certainty, Aid Administration and Compliance

As noted in our policy statement, the composition of a unitary group is predicated on a subjective and amorphous determination, employing such factors as “functional integration,” “economies of scale,” and “flow of value.” In stark contrast, the determination of the federal consolidated group is based on a single, objective measurement – ownership percentage. The federal standard for determining the affiliated group is clear, certain, and predictable. S.B. 367 would piggyback on this existing compliance requirement and allow corporate taxpayers to report income under the CIT based on a similar affiliated group concept, but with certain amendments to align with common state reporting requirements (such as the employment of a 50% ownership threshold).

Allowing Michigan corporate taxpayers to elect to use the affiliated group instead of the unitary group for reporting corporate income would avoid the uncertainty inherent in determining the composition of the unitary group, as described in the COST policy statement above. Instead of analyzing subjective aspects of the taxpayer's business operations, the taxpayer and Treasury may apply the objective criteria of ownership under the federal rules. A ten-year, irrevocable election, with limits on subsequent switching between the affiliated and unitary group reporting methods, provides a bulwark against abuse. It also limits the tendency of taxpayers, and the taxing authority, to view unitary business indicators in the light of what will produce less, or more, revenue from a given return. Removing this subjective element from the analysis will decrease audit time and litigation costs.

For the reasons listed above, I respectfully urge the Committee to favorably report S.B. 367. Please contact me with any questions you may have as you consider this important legislation.

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cc: Doug Lindholm, COST President and Executive Director
COST Board of Directors